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SUBJECT: NIZHNIY NOVGOROD: TRANSFORMING RUSSIA'S DETROIT  
TO ITS SILICON VALLEY

REF: MOSCOW 2417

Classified By: ECONMINCOUNS MATTHIAS MITMAN, REASONS 1.4 (B,D)

11. (C) Summary: This year's Nizhniy Novgorod Scientific and Industrial Forum focused on President Medvedev's "Five I's" (innovation, investment, intellect, infrastructure and institutions). Nizhniy Novgorod Governor Shantsev, perceived to be business friendly and well connected to the Kremlin, claimed that his oblast epitomized the Five I's with its strong science and technology infrastructure; a development strategy focused on innovation and modernization; and an aggressive investment promotion program. Senior oblast officials did not hide the fact that the area's industries, particularly the GAZ automobile works, were hard hit by the financial crisis, but maintained that living standards and overall employment remained higher than the Russian average. While the regional development strategy has concentrated on supporting the mainstays of the economy -- such as the automobile and aviation industries -- a significant amount of budgetary resources are being allocated to promote innovative technologies and the region's R&D and education potential. Foreign investors are generally bullish about Nizhniy Novgorod's future potential as a hub of the new knowledge-based economy, but note that certain investment safeguards (IPR protection and infrastructure) must be in place before the region is fully linked to the global economy. End Summary.

Nizhniy Embodies the Five I's  
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12. (SBU) On October 28-November 1, Nizhniy Novgorod hosted the 14th annual "Russia United" Scientific and Industrial Forum, with nearly 3,000 participants and trade exhibits from the major cities of the Privolzhkiy Federal District, Russia's industrial heartland. The theme of this year's forum was the concept of the "Five I's" (innovation, investment, intellect, infrastructure, and institutions), declared by President Medvedev as the main directions for national economic development. Nizhniy Novgorod Governor Valeriy Shantsev, keynote speaker at the Forum's plenary session, declared that the Nizhniy Novgorod region epitomized the Five I's. Firstly, while the local economy lacked oil and gas resources, it was one of the largest R&D centers in Russia and was actively modernizing its processing industries (petrochemicals, metals, and food) with the automobile industry (i.e., the GAZ works) in a stable position. Secondly, Nizhniy Novgorod had one of the best developed systems of higher education in Russia, with its universities

graduating 50,000 students a year -- many with degrees in engineering and in the fundamental and applied sciences. Thirdly, Nizhniy Novogord had developed some of the best investment legislation in Russia, offering tax breaks and other supports to investors, making Nizhniy Novgorod effectively a "special economic zone." The Governor took great pride in the Oblast Investment Council (which he heads), designed to function as a one-stop shop for investments, removing -- to the extent possible -- administrative barriers and red tape.

#### How Nizhniy Survived the Financial Crisis

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13. (C) In a meeting with Econoff on the eve of the Forum, Oblast Minister of Economy Genadiy Balandin acknowledged that the financial crisis did not spare Nizhniy Novgorod: overall industrial output fell about 40 percent in the first six months of 2009, but was now steadily rising. He explained that the "socio-economic fundamentals" already in place before the crisis (high level of education, emphasis on R&D, and rising level of investments) had softened the impact of the crisis on the population. The recession notwithstanding, per capita income had grown 2.2 times since 2006 and the regional (officially registered) unemployment rate (1.77 percent) was lower than the average for Russia (2.8 percent). (Note: Unemployment figures in Russia understate the true situation. End note). He said the Oblast Development Strategy targeted regional and federal budgetary funds not only for "social obligations" but also targeted large scale construction of infrastructure facilities: 17 road, metro and

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bridge projects and over 600 school, hospital and sports facilities were being built or reconstructed.

14. (C) Balandin outlined what he (and Governor Shantsev) believed were the elements of Nizhniy Novgorod's development program that distinguished it from other regions. The oblast's program defined the region's long-term industrial priorities based on two criteria: attractiveness of the industry in terms of its contribution to the regional economy and the ability of the public and private sectors to shape a proper environment for the development of that industry. The first group of priorities included a mix of the traditional and "new economy" sectors: the automotive industry, science and education, IT, electronics and instrumentation, and pharmaceuticals. The oblast government would provide support for innovative project implementation through a mixture of tax breaks and partial subsidization of interest rates on commercial bank loans. Furthermore, oblast funds would be spent on developing infrastructure for innovation: i.e., technoparks, scientific innovative centers, centers for the commercialization of scientific and technical innovations, S&T grants and prizes, and professional development programs.

15. (C) Another key element of the region's development program, Balandin noted, was the emphasis on small and medium sized enterprises (SMEs). Employees of the region's 94,000 plus SME's comprise about 37 percent of the total work force. In 2008, the oblast spent 42.7 million rubles in subsidizing bank loan interest rates for SMEs as part of a broader program of financial and credit support. Another 1.6 million rubles were spent on subsidizing credit insurance for SMEs. An investment trust was set up in 2008 to support small enterprises in the scientific and technical sectors. Other institutions supporting SMEs include the Nizhniy Novgorod innovation business incubator, 26 development centers, business associations, consulting and learning centers, and leasing companies.

16. (C) Oblast Minister of Industry Nikolai Sataev, in a separate meeting, confirmed that the standard of living in Nizhniy Novgorod was higher than the average for Russia, but noted that labor productivity and the level of technology in the oblast's machine building sector were as much as 20 years

behind the U.S. and Western Europe. Sales of automobiles, produced mainly in the Gorky Automotive Plant (GAZ), had plummeted by 78 percent over the past year, but GAZ hopes that its new, low-priced, economy-size passenger car "Gazel" will appeal to cash-strapped Russians and help revive the plant. In spite of the economic downturn, layoffs at GAZ were kept at a minimum (in the hundreds, not the thousands), Sataev claimed. GAZ (with oblast assistance) was seeking to avoid social unrest by retraining workers slated for dismissal and offering them jobs elsewhere in Nizhniy Novgorod. Sataev added that GAZ was not accepting federal assistance, and (unlike the situation with Avtovaz), the central government was not interfering with GAZ's management or placing conditions on the plant's operations.

#### Aggressive Investment Promotion

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17. (C) The pillar of the region's investment program is the Investment Council under the auspices of Governor Shantsev and the Oblast Minister of Innovation and Investment Dmitry Svardkovskiy - a former Olympics Pentathlon champion. Economics Minister Balandin reiterated the Governor's assertion that the Council serves as one-stop shop for providing investors (particularly in the priority sectors) with land permits and other registration. As a result, Balandin claimed, investment in the region had increased threefold since 2006, particularly in the retail, construction and machine building sectors. The region's main trade partners outside the CIS are Germany, China, Finland, Sweden and the United States. Balandin said the Governor puts great stock (and budgetary resources) in hosting large-scale regional investment fora, such as "Great Rivers" and "Russia United" as well as participating in international exhibitions, such as MIPIM (France), Brussels Eureka, and ITB Berlin.

8 (C) Governor Shantsev and many of his staff have traveled

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the United States to expand business ties. Vice Governor Vladimir Ivanov told Econoff that Governor Shantsev plans to go to the United States next February and wants to meet with senior U.S. economic and trade officials (including Commerce Secretary Locke) in Washington; establish sister state/oblast ties with Maryland; and explore joint medical projects in Philadelphia.

#### View from the Business Community

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19. (C) We asked a number of business representatives at the "Russia United" Forum to assess the business and investment climate in Nizhniy Novgorod. Vladimir Bogdanov, Operations Manager of Intel's Nizhniy Novgorod operation, listed the oblast's three major attractions for high tech multinationals: the cost of doing business was cheaper than in Moscow; the level of education, (particularly in engineering, the computer sciences and mathematics) was high, second only to Novosibirsk; and the oblast government was "relatively speaking" pro-business. Corruption was less than in Moscow, Bogdanov explained, because the local government tried to act as a buffer between foreign investors and the traditionally rapacious bribe-takers: fire marshals, tax inspectors, etc. Moreover, he said, the local authorities seemed to respect the fact that Intel did business transparently and refrained from corrupt practices. Intel was regarded as a "strategic investor," training Russians from all universities in its internship program, and giving them an opportunity to work in their native country, thereby "reversing the brain drain." Bogdanov said that Governor Shantsev was seen as having considerable weight in Moscow and had effectively lobbied for the interest of local business. The major downside of investment in Nizhniy Novgorod, in Bogdanov's view, was the lack of infrastructure (relative to Moscow), i.e., problems with the water supply and electric

power.

¶10. (C) The Amciti General Director of the Swiss-based investment fund Skybridge Capital said he was impressed with Governor Shantsev's commitment to modernize Nizhniy Novgorod and transform it into a high-tech, knowledge-based economy. He commended the Governor for having the sense to know that the government needs to "get out of the way of business" and support it through tax incentives rather than direct intervention. In his view, the onus was on the federal government to help reduce the risks for foreign investors through IPR protection and investment legislation. Miki Vehvilainene, representative of Nokia-Siemens Networks, remarked that Nizhniy Novgorod had the basic ingredients to become a Russian Silicon Valley (high competencies and relatively low costs) and needed only to be linked to global markets via potential foreign investment. He also noted that the economic crisis seemed to have forced at least the forward-thinking elements of Russian business and officialdom to think seriously about creating efficiencies and innovation.

¶11. (C) Comment: Nizhniy Novgorod clearly appears to be one of the more developed and investor-friendly industrial regions of Russia. Regional scientists and engineers, many drawn from the military-industrial and atomic energy sectors, were based here during Soviet times when Nizhniy Novgorod was known as the closed city of Gorky. These high-tech entrepreneurs have been at the forefront of the oblast's new economy, embodied in the Intel and Siemens investments. As noted in reftel, Governor Shantsev's strong connections to Moscow's political and business elite, as well as his attempts to modernize and diversify the economy, will help the region attract capital over the long term. Over the short and medium term, however, Nizhniy Novgorod will remain a crossroads between Russia's Detroit and Silicon Valley. The traditional industries (automobiles, metals, and petrochemicals) still employ the bulk of the work force. The metallurgical and petrochemical industries have revived somewhat because of the upturn in the global commodities markets. Lingering low levels of domestic demand and consumption, however, will delay recovery in the automobile and aviation industries, draining resources from the regional budget that might otherwise have been spent on innovation and infrastructure development. End comment.

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